

**BEFORE THE
U.S. DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C. 20590**

In the matter of Computer Reservations System (CRS) Regulations Statements of General Policy	
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**Docket OST-97-2881
OST-97-3014
OST-98-4775
OST-98-5888**

Introduction

The severe crisis the world airline industry is undergoing requires the current legal framework regulating the CRS business model to be revised.

We expect the proposal for modifying the current CRS regulation to become a first step in a streamlining effort to deregulate and allow the market forces to act with more freedom in favor of the most cost effective services and in turn in favor of the final consumer.

In line with the aforementioned, the new regulation should certainly be based on the following principles:

Fundamentals to be encompassed in the new business model

- The free action of the market forces will incentive the development and selection of more efficient, cost-effective distribution channels.
- The freedom of the supplier to choose the system or systems and the connectivity level and services through which end customers receive the product at each point of sale -regardless of the supplier having an ownership share in or a marketing relationship with a CRS-, as long as the supplier pays for the CRS costs, will incentive the CRS to provide more competitive and more cost-effective solutions to the supplier.
- The freedom of the supplier to make the distribution cost "transparent" by partially or totally transferring distribution channel cost differences either to travel agents or final customers, will allow market forces to act freely and better informed, favoring the most cost effective distribution channels.
- The freedom of CRS and suppliers to bilaterally negotiate economic conditions will allow both parties to make a more efficient use of economic resources in each of the markets where they participate.

We believe that the aforementioned principles would not eliminate in the short term certain practices of the CRS that strongly lock travel agents to them and prevent more cost effective alternatives to be implemented:

CRS incentives to travel agents for booking goals.

Exclusive use of the PCs installed at travel agents by the CRS.

Consequently, regulations aimed at ending these two practices in the short term should be introduced.

Current Situation

Travel agencies are the most important distribution channel for airlines in our region, accounting for more than 70% of their total sales in Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Uruguay, USA and Venezuela.

In domestic and regional routes strongly relying on low fares, CRS represents the most significant component of the distribution cost of the airline. As a result of this, introducing substantial changes to the distribution model becomes a must.

Given the significance of the travel agent channel, there are critical limitations that need to be solved, which will undoubtedly be in the best interest of final consumers:

- a) Customers do not really perceive channel related cost differences. Accordingly, customers make their purchase decisions regardless of the cost of the chosen distribution channel. In turn, efficient CRS end up subsidizing inefficient ones. These uninformed decisions are detrimental for the economic efficiency of the industry, hence, damaging end consumers. As an example, there is a CRS that has held the lowest booking fee over the last few years and has experienced no market share increase, although no major functional and service differences may be observed.
- b) CRS deliver significant incentives to travel agents in order to guarantee the exclusive use of that particular CRS by the travel agent, as well as attaining production goals. These incentives act as strong entry barriers for lower cost, alternative distribution systems and at the same time increase the inefficiency in the use of the system –measured as net bookings per flown passenger-. The effectiveness of these incentives -from the CRS' standpoint- has resulted in booking fees substantially rising every year, in spite of the major technological breakthroughs available. Moreover, as opposed to what we observe among airlines, where a more competitive tariff immediately translates into a growth of market share, the absurd phenomenon of increasing market share pressure following increasing booking fees is observed among CRS. This “reverse competition” phenomenon produces on

the more cost effective systems a permanent pressure to increase booking fees in order not to lose market share.

- c) Through severe penalty clauses in their subscriber contracts with CRS travel agents are not allowed to use the PCs installed by the CRS to access alternative systems. Since in many cases the systems have financed or even own the travel agent PC networks, these exclusivity clauses built in long term contracts with travel agents act as extremely effective entry barriers for competitive systems, substantially delaying the penetration of lower cost technology in the market and substantially increasing and preserving the travel agent inefficiencies in time.
- d) As a result of the parity provisions existing in participating carrier agreements with the CRS, the airlines are unable to freely choose the CRS and connectivity level through which they would prefer to distribute their product in a given travel agent. The airline is forced to support for a given travel agent the CRS chosen by the travel agent, at the same connectivity level of competing systems in the market, independent of the cost resulting for the airline.
- e) Cost reduction initiatives today are exclusively restricted to matters related to the inefficiencies caused by travel agents as a result of unnecessary activity. More effective initiatives, such as a competitive reduction of CRS tariffs, are not applicable as a result of the existing non-discrimination fee rules.
- f) Present CRS tariffs show substantial differences with the cost associated to direct distribution channels (ATO/CTO, airline web sites, call center), thus damaging the commercial relationship between airlines and travel agents.

The distribution issues airlines have to face within the travel agent channel are related to the current rules governing the CRS. Mandatory participation rule, parity clause, non-discriminatory fees, incentives to travel agents and exclusive PC use are some of the issues requiring the most urgent solution.

In order to encourage all industry players to deploy more cost effective ways of reaching and servicing the final customers, obsolete constraints in the distribution model are to be urgently revised.

LanChile Comments on DOT Proposal

In general terms, we agree on the approach proposed by the DOT to deregulate and allow market forces to introduce efficiency and better services, only keeping the rules required to prevent anticompetitive practices by the different players involved.

Following are our main comments on the new proposal by the DOT.

255.4 Display of Information

Unbiased information on travel agents' displays results in market transparency towards end customers.

In order to ensure CRS' neutral nature, regulations invariably favoring the best airline products available, based on neutral selection criteria (elapsed time, single-plane flights, connecting services), are to be kept.

255.6 Contracts with participating carriers

(c) CRS should provide a breakdown of all the transactions carried out for an airline, not only to validate billing and charges by the CRS, but also in order to know all the transactions carried out by the travel agencies, so that the efficient use of the system may be boosted. Consequently, information in excess of that specified by the DOT is required: bookings canceled within the non-crediting period, bookings ticketed, including ticket number, issued, void, canceled, etc.

The cost of every transaction should also be included, in order to prevent every airline from bearing the costs related to the complex processing of all the transactions inherent to every CRS along the different periods of effectiveness. Every CRS should be liable for providing information in a detailed and simplified manner for airline management purposes.

(d) The participation parity provision should be eliminated in its entirety, with no exception applicable to carriers having an ownership share in or a marketing relationship with a CRS, since these carriers will always be bound to hiring CRS services, as a result of the current market structures.

Should the DOT keep this rule, participation of airlines in this case should only be at those connectivity levels that do not imply a unit cost for the airline higher than the unit cost of the lowest participation level in the market for the specified CRS.

255.7 Contracts with Subscribers

(c) Incentives jeopardize free competition among CRS as they account for an insurmountable barrier to access; they also undermine distribution efficiency and consequently force distribution costs to rise since, in their attempt for capturing travel agencies, CRS raise incentives, which have in turn resulted in higher booking fees, thus damaging end consumers.

One example of this situation may be currently found in the Chilean and Argentinean markets, which Galileo has disclosed it will be leaving by mid 2003, thus forcing travel agents to choose a new CRS. Most travel agencies are solely focused on the substantial incentives offered by the remaining systems, which will most likely be offset by means of booking fee increases in the region and aggressive productivity goals.

In the case of LanChile, where most bookings are generated through the travel agent channel, the net bookings to flown passenger ratio in this channel amounts to 1.38, showing that a substantial proportion of the booking transactions completed by these travel agencies are deemed unnecessary and inefficient, thus raising our airline's distribution system costs by 38%. On top of the extra cost associated to the booking fees of these unnecessary bookings, there is the resulting blockage of inventory for sale. In high load factor flights the latter may result in a substantial revenue loss for the airline.

The transactions generating this inefficiency are usually related to duplicated, passive, no-show bookings (bookings created by agencies without an actual travel intention), late cancellations (they are not credited to airline), etc.

A major proportion of the CRS revenues stem from charges to the airlines. However, there is no actual motivation for the systems to be competitive from the airline's standpoint, thus generating large inefficiencies and high distribution costs. Independent of increasing or decreasing industry size CRS tariffs increase every year for the same services they provided the year before.

Accordingly, the market shows that inefficient and poor service systems remain as relevant players for a long time.

In an attempt to improve the transaction efficiency of travel agencies, reduce distribution costs and free inventory for sale, a large number of airlines keep "flight firming" or "revenue integrity" initiatives by canceling bookings in their inventory that fail to show an actual travel intention (Time Limit, Advanced Purchase, Valid Ticket, Dupes, firming, etc). An electronic message is submitted to the travel agent every time a booking is cancelled in the airline's inventory. Maintaining these initiatives also involves a relevant operating cost for the airlines, it incorporates an additional complexity to the distribution process, and results in a negative impact on travel agents and end customers.

In spite of these efforts, airlines do not entirely benefit from the potential savings. Although carriers make a huge effort to cancel bookings in their inventory that do not represent a real travel intention, with a corresponding electronic message informing the travel agent, CRS credit the airline only when the travel agent that generated those bookings proceeds to cancel them in the system. Galileo has recently disclosed that booking cancellation by the travel agency will no longer be required for the bookings to be credited to airlines in the case of travel agencies in the U.S., Canada and Mexico.

Should CRS be motivated to improve its efficiency, the CRS itself would be able to offer automated tools to airlines and travel agencies, so that the aforementioned situations could be prevented. Moreover, we believe that within the framework of the present CRS rules the prohibition of travel agent incentives may substantially increase the efficiency and reduce distribution costs.

All this described lack of efficiency and higher related costs are detrimental to the relationship between the airline and the travel agency channel and ultimately causes an impact on end customers.

225.8 Use of third-party software and databases

(a) Most CRS in the region set forth provisions enforcing exclusive use of the PCs, thus restricting access to new distribution systems based on latest-generation, cheaper and more efficient technology.

When no exclusiveness provisions are involved, extravagant compensations are required by the CRS from travel agencies for the use of the PCs.

By restricting access to other systems through the PCs installed at travel agencies, the CRS renders use and proliferation of newer and better distribution alternatives inapplicable for a long term.

Incentives and inability to use agencies' PC act as a major deterrent for the introduction of newer technologies and provision of better products and services to customers.

(b) In order to prevent the CRS from delaying the certification of third-party hardware, software and databases, a deadline for completion of the certification process by the CRS should be established.

255.9 Marketing and booking information

Using MIDT boosts competition among airlines, which consequently results in a benefit to end consumers. Airlines will compete based on more comprehensive data and in a more transparent manner.

Failing to count on travel agent data will increase access barriers to new markets and prevent smaller airlines from identifying business opportunities in those markets. Failing to count on all the market information required (airlines and travel agents) will result in those airlines currently having a larger market share to grow stronger, thus restricting the access of smaller rivals.

By being acquainted with the airline's market share in the travel agency channel, carriers prioritize their promotion and segmentation plans, thus streamlining commercialization of their products and making a more efficient use of their marketing budgets.

Consequently, losing travel agent level information in the MIDT will result in a less efficient marketing activity for the airline, translating directly in higher distribution costs and thus higher tariffs for the final consumer.

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